DOCKET FILE COPY ORIGINAL

RECEIVED

JAN 11 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	**CC Docket No. 94-1**
	)	

To: The Commission

COMMENTS
OF
AMERICAN PETROLEUM INSTITUTE

The American Petroleum Institute ("API"), by its attorneys, hereby submits its Comments in response to the Fourth Further Notice of Proposed Rulemaking ("Notice") adopted in the instant proceeding on September 27, 1995, by the Federal Communications Commission ("Commission"), FCC 95-406 (released on September 27, 1995). API has participated extensively in this proceeding. It submitted Reply Comments in response to the Notice of Proposed Rulemaking adopted on January 19, 1994, FCC 94-10 (released on February 6, 1994).

I. Overview.

The Commission has correctly identified three essential characteristics of any X-Factor: it should be economically valid, it should ensure consumer benefit, and it should be reasonably simple and based on accessible and verifiable data.[1] An X-Factor that best embodies these characteristics is one that, if calculated on a total factor productivity ("TFP") method, (1) includes only interstate data and (2) errs on the high side, to compensate for performance measures limited to the local exchange carrier ("LEC") industry.

II. The Commission Must Not Lose Sight of the Intended Purposes of a Productivity Offset.

A LEC productivity target is intended to achieve certain Commission goals, including principally that interstate rates be just, reasonable, and nondiscriminatory.[2] The price cap plan seeks to achieve this and other goals by replicating many of the incentives of the competitive market, thereby encouraging price cap LECs to make economic decisions similar to those they would make in a fully competitive market.[3] For these reasons, setting a reasonable target and requirement for LEC

---

[1] Notice, para. 16.

[2] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, FCC 95-132, paras. 65, 90-91 (released Apr. 7, 1995) (hereinafter "First Report and Order").

[3] Ibid.

productivity is one of the critical tasks in ensuring that the price cap plan will work as intended.[4]

An X-Factor designed to replicate a competitive market and incent productivity increases must necessarily generate some anxiety among the price cap LECs. The LEC response to the First Report and Order suggests, however, that the current range of X-Factors is set too low and improperly provides the LECs with insulation from competition. The fact that a clear majority of price cap LECs elected the highest productivity offset available indicates that the range needs to be revised upward to ensure that the price cap plan works as intended.

The sheer number of questions posed in the Commission's Fourth NPRM dispels the notion, advanced by the United States Telephone Association ("USTA") and the LECs, that a total-company TFP factor can be "generated and verified quickly, easily, and mechanically."[5] While API would prefer a less complex approach to calculating an X-Factor than the TFP method, it would find that method acceptable if modified in two key respects: by relying on interstate data

---

[4] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786, para. 75 (1990) (LEC Price Cap Order); recon., 6 FCC Rcd 2637 (1991) (LEC Price Cap Reconsideration Order), aff'd sub nom. National Rural Telephone Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

[5] First Report and Order, para. 158.

only and by expanding the measure of performance to include telecommunications providers other than LECs. Further, the various "inputs" into the proper TFP methodology must reflect realistic economic data and assumptions.

III. The Commission Is Urged to Adopt an Interstate TFP, Rather Than a Total Company TFP.

The goals of economic validity, consumer benefit, and administrative simplicity will be furthered by the adoption of an interstate-only TFP-based X-Factor. Fundamentally, LEC growth and productivity gains have been largely confined to interstate services, which account for only three of seven output categories specified in the Christensen Study. Consequently, including intrastate services in the TFP output index skews the results and ensures a systematic downward bias in TFP.[6] This downward bias leads, ultimately, to interstate rates that are higher than warranted, calling into question whether those rates are, indeed, just, reasonable, and nondiscriminatory. The downward bias diminishes the economic validity of the TFP, because the resultant higher rates send incorrect market

[6] During the period 1984-92, the output quantity growth rate calculated on a total company basis averaged 3.5%, according to the Christensen Study. Calculated on interstate basis, that growth rate averaged 6.2%, according to a February 14, 1995 _ex parte_ notice and filing by Leah Moebius on behalf of the Ad Hoc Telecommunications Committee.

signals. A mechanism that generates incorrect market signals is an impediment to economic development and is inconsistent with the Commission's preference to "minimize distortion of competitive marketplace forces in telecommunications."[7]

Further skewing the results is the fact that intrastate services are not capped under the price cap plan. This fact may partially account for the Commission's difficulty in replicating the Christensen Study price indices for local services, intrastate access, and long distance service.[8] Moreover, while the states appear to be moving towards price cap regulation, there is significant lack of uniformity between the Commission's price cap scheme, on the one hand, and the various state incentive regulatory plans and the variations of rate-of-return regulation which are still followed in major states, on the other. Because jurisdictional constraints preclude correction at the state level, differing regulatory approaches virtually ensure that price cap LECs will receive windfall benefits from a total-company TFP-based X-Factor.

An X-Factor that is lower than warranted awards productivity gains to the price cap LECs, rather than to

---

[7] First Report and Order, para. 94.

[8] Notice, para. 26

consumers. This result is inconsistent with the Commission's goal of maximizing benefits to consumers and society. It is also inconsistent with the goal of replicating a competitive market.

An interstate-only TFP has the added benefit of administrative simplicity. Among other things, a more limited TFP reduces the number of indices that must be constructed, thereby facilitating both the Commission's and the parties' review. The record suggests that accuracy may even be improved since, for example, neither the Commission nor the parties need expend resources attempting to replicate, challenge, and correct the apparently ad hoc method used in the Christensen Study to calculate price indices for intrastate services. Further, because an interstate-only X-Factor can be calculated from information generated under current reporting requirements, specifically ARMIS, modification of Commission rules is unnecessary.[9]

IV. From A Policy Perspective, Productivity of Competitive Telecommunications Sectors Should be Reflected in the "X" Factor.

API supports the inclusion of productivity data for both LECs and other telecommunications firms. The Commission, however, may face real obstacles in obtaining the data necessary to calculate such an industry-wide

---

[9] Notice, para. 68.

measure. Consequently, it may choose to rely on a performance measure limited to the LEC industry.

The productivity of the telecommunications industry, not just the LEC industry, is essential to devising an economically valid TFP. The core LEC services are not subject to meaningful competition; to the extent the LEC industry does face competition, it is de minimis. In these circumstances, if the Commission limits performance measures solely to LECs, it will be relying on the productivity associated with firms in non-competitive markets to establish the surrogate for the competitive market. Such a productivity offset would not begin to approximate the competitive marketplace.

Moreover, the resulting productivity offset fails to serve the other key objective: serving as an incentive to increased productivity gains. Introducing the productivity levels of telecommunications players other than LECs will subject the LECs to the pressures -- incentives -- imposed on firms in the balance of the highly competitive telecommunications industry.

Expanding the measure of performance also serves as a constraint on the ability of price cap LECs to manipulate price cap regulation to continue to earn monopoly profits. The recent election of the highest X-Factor by eight of 12 price cap LECs demonstrates that the current X-Factors are set too low, thereby assuring continued receipt of monopoly profits.[10] These elections should serve as the Commission's "reality check" as it establishes a revised productivity target.

The Commission may face obstacles in obtaining the data that is required to calculate such an industry-wide measure. Valid concerns exist with respect to timely receipt, verifiability, and public availability of such data. Moreover, devising an industry-wide performance measure adds yet another level of complexity to the calculation of the X-Factor. Thus, an industry-wide index may be at odds with the goal of administrative simplicity.

The Commission may achieve the benefits associated with an industry-wide performance measure, without engendering additional administrative burdens, simply by favoring consumer interests as it calculates the X-Factor. This approach is predicated on and furthers the Commission's stated objective of ensuring that consumers benefit from productivity gains. Thus, for example, when the Commission must choose among assumptions, its selection should be the one that results in a higher X-Factor. This approach enhances the economic validity of the X-Factor. An X-Factor weighted in favor of consumer interests replicates the incentives of a competitive market and compensates -- if

---

[10] Notice, para. 8. GTE selected the highest factor for 38 of its 46 study areas.

only partially -- for the competitive advantages that entry barriers and pricing flexibility confer upon price cap LECs.

V. Potential Competition Does Not Warrant a Relaxation of Sharing Obligations.[11]

It is premature for the Commission to consider a relaxation of LEC sharing obligations. As noted above, the core services provided by price cap LECs are not currently subject to meaningful competition. Because it is far more reasonable to assume competition to be years away, any relaxation granted now would be granted merely in anticipation of meaningful competition.

In the absence of actual and effective local exchange competition, the sharing mechanism remains a necessary component of a price cap regulatory regime. Only with this mechanism does the LEC have an incentive to elect a more challenging X-Factor, one that promotes the benefits that price cap regulation can provide. Alternatively, a super-aggressive X-factor might provide the basis for elimination of sharing.

The Commission must not, however, relax the X in light of possible or "anticipatory" competition as proposed by

---

[11] This section addresses related issues raised in paragraphs 159 through 172 of the LEC Pricing Flexibility NPRM, Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, FCC 95-393 (rel. Sept. 20, 1995).

NYNEX.[12] The Commission's recent decision on AT&T's nondominant status was based in part on AT&T's overall interstate market share being something less than 60% of the aggregate market measures.[13] Until a Price Cap LEC is subject to a comparable level of competition, relaxation of the X-factor would be wholly inappropriate.

WHEREFORE, PREMISES CONSIDERED, the American Petroleum Institute respectfully urges the Federal Communications Commission to maintain and further the goals of local exchange carrier price cap regulation by taking action consistent with the views expressed herein.

Respectfully submitted,

AMERICAN PETROLEUM INSTITUTE

By: C. Douglas Jarrett

Wayne V. Black
C. Douglas Jarrett
Susan M. Hafeli

Keller and Heckman
1001 G Street, N.W.
Suite 500 West
Washington, D.C. 20001
(202) 434-4100

Its Attorneys

Dated: January 11, 1996

---

[12] LEC Pricing Flexibility NPRM, para. 165, footnote 247. For example, simply because a competitor has announced plans to "collocate" is irrelevant to a demonstration of meaningful competition.

[13] In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, (Order, FCC 92-42) (released October 23, 1995), Appendix B.

CERTIFICATE OF SERVICE

I, Cassandra L. Hall, a secretary in the law firm of Keller and Heckman, hereby certify that a copy of the foregoing was served by hand-delivery on this 11th day of January, 1996, to the following:

Industry Analysis Division
Common Carrier Bureau
Federal Communications Commission
Room 534
1919 M Street, N.W.
Washington, D.C. 20554
(computer disk)

Tariff Division
Common Carrier Bureau
Room 534
1919 M Street, N.W.
Washington, D.C. 20554
(2 copies)

Cassandra L. Hall
Cassandra L. Hall